No. 22607

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ATHALIE IRVINE SMITH,

Appellant,

vs.

THE JAMES IRVINE FOUNDATION, a corporation, *et al.*,

Appellees.

Appeal From the United States District Court
Central District of California.

APPELLANT'S REPLY BRIEF TO BRIEF FOR APPELLEE THE ATTORNEY GENERAL OF CALIFORNIA

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REPLY TO BRIEF OF ATTORNEY GENERAL

The Attorney General of California does not question the contention of the plaintiff that a trust cannot be established to exist in perpetuity for both charitable and non-charitable purposes. The Attorney General, however, takes issue with the legal effect of paragraph 2 of the 1937 Indenture of Trust, which provides that one of the purposes of said trust is that the trustee may invest all or any portion of the balance of the income received by said trustee from the dividends on the Irvine Company stock after the payment of administration expenses and the

replacement of losses to corpus. The Attorney General attempts to define this express mandate of the trustor for the diversion of trust income for private uses as not constituting a noncharitable purpose. There is no limitation imposed on the trustee as to what percentage of the balance of said trust income may be invested and thereupon frozen into the corpus of the trust estate.

The basic and vital objection of the plaintiff to the investment provision in paragraph 2 is that there is no fixation of a definite percentage of the trust income which may be devoted to the noncharitable investment purposes, but it is left to the absolute discretion of the trustee as to what percentage of the balance of said income, if any remains after said investment purposes have been fulfilled, shall be received and devoted by the trustee for wholly charitable purposes. A valid provision would require that the trustee be limited to a reasonable definite percentage of said trust income for such investments or additions to capital. A comparison of the investment provisions in paragraph 2, which is invalid and renders the entire Irvine trust void, with a provision which is valid, is set forth in the indenture of trust of the Duke Endowment Foundation, and which will be found in the case of *Norman A. Cooke, et al. v. Duke University, et al.* 200 North Carolina 1. The investment provision in the Duke Endowment Foundation indenture of trust limits the diversion of the trust income for investment purposes and additions to capital to 20% thereof, and further provides that such income investment use shall terminate after the amount of 40 million dollars has been reached. No such limitation in any percentage or maximum amount is placed upon the trustee in paragraph 2 of the Irvine Indenture of Trust. Furthermore, the Duke Endowment Fund trustees are also limited in the character of investments to the securities of the the Duke Power Co., or in

bonds issued by the United States of America, or by a state thereof, or by a district, county, town or city. No restriction of any kind is placed on the trustees of the Irvine Foundation with reference to the character of investments.

Under the law as established in California, it makes no difference whether the trustee may devote all or any part of the trust income for noncharitable purposes, for it is mandatory that the trustee shall have no option to devote any part of the trust income to any purposes which are not wholly charitable.

The rule that a discretion given to trustees to use trust property for charitable purposes and also for noncharitable purposes makes the trust invalid is supported by the following cases which are discussed in the brief for the appellant: *Estate of Hinckley, Estate of Sutro, Estate of Vance, Estate of Klein, and Estate of Peabody.*

In the *Estate of Sutro,* the trustor requeathed land in trust to be conveyed by his executors to a board of trustees and thereafter to be sold and after the death of trustor's children to be applied "by said board of trustees for such charities, institutions of learning, and science and for premiums to be set apart for distinguished scholarships and scientific discovery and inventions as shall be directed by my executors."

Under the provisions of the 1937 Irvine Indenture of Trust, the foundation trustee is required or permitted to invest all or any portion of the income received from the Irvine Company stock dividends after the payment of expenses of administration and making good any losses to corpus in any property or securities which the trustee shall determine proper or advisable whether or not permissible by law as investment for trust funds, and any property which is acquired by the trustee from the

balance of said income after the payment of expenses of administration and the replacement of losses to corpus, shall be managed, controlled, improved, encumbered by mortgage, trust deed, or otherwise, at such times and on such terms as the board of directors of the trustee may in its discretion deem advisable.

Said Irvine Indenture of Trust further provides, "All discretions in this trust conferred upon the trustee shall unless specifically limited, be absolute and uncontrolled, and their exercise by the Board of Directors of the Trustee conclusive on all persons interested in this trust."

Obviously, the Attorney General of California has no authority or power to vacate or ignore this mandatory provision which gives the Irvine Foundation trustee uncontrolled discretion to invest any or all of the balance of said income in any property or securities or mortgages or anything else that pleases said trustee. Neither has said Attorney General any regulatory authority or jurisdiction of any kind over the Irvine charitable trust or any other charitable trust or charitable corporation in California.

Said permissible noncharitable investment use of the balance of said income, as provided in paragraph 2, further provides that the income and profits received from such noncharitable private investments, "shall thereafter be used, applied, and devoted as in this trust provided." It is therefore clear that this provision authorizes the trustee to continue to divert the income of said noncharitable private investments into other noncharitable private investments and not to exclusively devote such recurring investment income to wholly charitable purposes.

Under the foregoing provisions of said Irvine indenture of trust the trustee could devote the said balance of said income to acquiring a private school or any other private institution or enterprise through the incorporation thereof and the purchase of its stock or through mortgage loans or by acquiring the outright conveyance by said institution or corporation of all of its assets to the foundation trustee and the foundation trustee thereupon would manage and control the operation of said private noncharitable institution or corporation, which would be in violation of the law which is applicable to charitable trusts.

In the *Estate of Sutro,* the Supreme Court of California further stated as follows:

> "The fatal objection to the validity of the trust is that it authorizes the funds to be devoted to purposes other than charitable and that it leaves the question whether it is to be devoted to charitable purposes, or to other uses not charitable, entirely in the discretion of the executors, or, in the case of their default, in the discretion of the board of trustees."

The Supreme Court further stated:

> "Without violating the directions of the will the entire fund could be devoted to institutions of learning and science carried on for private gain, of which there are many, or to the encouragement of abstract scientific discoveries not tending to benefit mankind, or to reward inventions calculated to profit the investor alone, or those to whom he should transfer his secret or patent. The trustees could apply a part to each of the different objects, or they could apply the whole of it to one of them to the exclusion of any other. These objects not being exclusively or necessarily charitable, it follows, under the rule

> stated, that the entire trust was invalid, and that the decree of distribution was correct * * *".

The foregoing application of the law by the Supreme Court of California in the *Sutro* case is clear and unambiguous and under said law the investment provisions contained in paragraphs 2 and 3 of the Irvine indenture of trust which permit the foundation trustee to use all or a portion of the income received from the dividends on the Irvine Company stock for investments devoted to the same or similar noncharitable purposes which are described in the *Sutro* case, renders said Irvine trust illegal and void. There is absolutely no difference whatever between the noncharitable provisions contained in paragraphs 2 and 3 of the Irvine indenture of trust concerning the uncontrolled discretionary powers of said foundation trustee and the similar provisions which are contained in the Sutro will that permitted the trustees to devote a part of the trust funds to noncharitable purposes. The Supreme Court of California held that whether or not the Sutro trustees carried out said noncharitable provisions that were contained in the Sutro will was irrelevant as the inclusion of said provisions rendered the Sutro trust illegal and void, and the same rule of law applies to the invalid and illegal investment provisions in the Irvine indenture of trust.

In the case of *Wilkin v. Wilkin Trust,* 261 F.Supp. 977, the court stated:

> "The cases relied upon by plaintiff on this point (noncharitable and mixed trust provisions) are those which on the face of the trust instrument involved there is a mixed trust established, that is, one wherein the trustees are specially directed or permitted to use trust funds to either charitable or noncharitable recipients, or both. If such specific directions

or permission appeared on the face of this trust instrument those cases would be followed."

The cases referred to in the *Wilkin* case are the California cases of *Estate of Sutro, Estate of Klein, Estate of Vance,* and *Estate of Peabody,* which have all been discussed in the brief for appellant.

Furthermore, the Attorney General of California has no authority whatever to inject his office into the plaintiff's action by taking the side of the Irvine Foundation. There is no provision in any law in California which entitles the Attorney General to become other than a neutral party to any litigation which involves the validity of the Irvine indenture of trust which is the basis of plaintiff's action. The only jurisdiction or authority that is vested in the Attorney General is to file an action in court against the trustees of a charitable corporation or charitable trust where said trustees were guilty of maladministration of the charitable trust funds.

Similar activity to that which has been improperly undertaken by the office of the California Attorney General in his opposition to the plaintiff's action has recently been severely criticized by Congressman Wright Patman, Chairman of the Committee on Banks and Currency of the House of Representatives, United States Congress, for attempting to interfere with the Commissioner of Internal Revenue Service of the United States in connection with the collection of a federal income tax assessment in the sum of approximately $300,000 against a California foundation that was charged by said commissioner with illegal activities in violation of the internal revenue laws. The letter of Mr. Patman to said California Attorney General was referred to by the Los Angeles Times on August 7, 1968, and in this letter Mr. Patman accused Deputy Attorney General Wallace Howland, who is in charge of the supervision of the internal trustee

administration of charitable corporations and trusts in California with "serious dereliction of your official duty", for trying to save the illegal California foundation federal taxes rather than collecting California state taxes that should also be due for the same illegal activities that were charged against said California foundation by the Commissioner of Internal Revenue.

The contention of the defendant Foundation that said noncharitable private investment use of the trust income which is contained in paragraph 2 of said Irvine indenture of trust is merely a provision for the accumulation of income, is absurd. Said provision expressly states that when the income is invested by the trustee said investment, which could be a private institution or any other noncharitable enterprise, shall become a part of the corpus or principal of the trust property. Therefore, said noncharitable investment, when made, would forever lose their identity as income, accumulated or otherwise, and would forever be unavailable for charitable distribution as the Irvine trust is solely an income trust and the corpus of said trust can never be distributed.

Furthermore, under Section 501 of the Internal Revenue Act which prohibits a tax-exempt charitable foundation trust from accumulating its income and requires said trust to distribute all of its income currently for charitable purposes, the attempted construction placed on said paragraph 2 by the defendant Foundation would render the trust illegal and void. See the case of *Danforth Foundation v. United States,* 347 F.2d 673.

Respectfully submitted,

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Attorney from
Plaintiff-Appellant
Athalie Irvine Smith